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COMMERCIAL LETTERS OF CREDIT

(Concluded)

IN a previous article^{129a} an analysis was made of:

- I. The business transaction which gives rise to commercial letters of credit; and
- II. The rights of the seller, as the accredited party or beneficiary of the credit, against the issuing and drawee banks.^{129b}

^{129a} 35 HARV. L. REV. 539 (March, 1922).

^{129b} Two recent English cases which deal incidentally with the rights of the seller, as the accredited party, against the issuing and drawee banks have been brought to the attention of the writer since the first part of this article was published in 35 HARV. L. REV. 539.

In *Stein v. Hambro's Bank of Northern Commerce*, 9 Lloyd's List Law Rep. 433, 507 (K. B. D., decided Dec. 8, 1921, and Dec. 13, 1921), a seller in England sold hides to a buyer in Venice. The hides were to be shipped from India. The buyer procured an irrevocable letter of credit from the defendant bank, authorizing the seller to draw under certain conditions upon the defendant bank. The buyer, contending that a condition had not been met, instructed the bank to cancel the credit and to refuse acceptance, which was accordingly done. In an action by the seller against the issuing bank it was *held* that there had been a breach of the letter of credit contract and that the seller could recover the amount of the bill of exchange for which acceptance was refused. The case is concerned chiefly with the question of the measure of damages. The right of the seller to maintain the action, if the conditions had been met, seems to have been assumed without discussion. The theory underlying this result is therefore conjectural. Mr. Justice Rowlatt said in part: "It seems to me that this is clearly a case of a simple contract to pay money upon the fulfillment of conditions which have been fulfilled. . . . The obligation of the bank is absolute, and is meant to be absolute, that when the documents are presented they have to accept the bill. That is the commercial meaning of it."

In *Urquhart, Lindsay & Co., Ltd. v. Eastern Bank, Ltd.*, 9 Lloyd's List Law Rep. 572 (K. B. D., decided Dec. 5, 1921), the seller in England contracted to manufacture, over a period of months, and to deliver machinery to a buyer in India, prices to advance according to advances in costs of labor and materials, payment to be made by a confirmed, irrevocable letter of credit. The buyer obtained a letter from the defendant bank in which the defendant bank promised the seller to pay the seller's drafts on the buyer, accompanied by specified shipping documents. The seller made two shipments and received payment according to the terms of the letter. The seller had added to the invoice price the increase in the costs of labor and materials. The buyer instructed the defendant bank to pay in the future only the original invoice prices. The defendant bank proceeded to carry out these instructions. Thereupon the seller cancelled the sales contract on the ground that it had been repudiated by the buyer and brought

In this article an examination will be made of:

III. The rights of the purchasing bank against the issuing and drawee banks;

IV. The rights of the issuing and drawee banks;

V. The suretyship element in the letter of credit transaction; and

VI. Assignability of the letter of credit.

The nature of the authority conferred upon the seller presents the most difficult problems in the subject of letters of credit. The rights of the purchasing bank against the issuing and drawee banks and the rights of the issuing and drawee banks present no great difficulties. On the whole, the law in reference to these matters may be said to be fairly definite and uniform. Most of the cases involving commercial letters of credit have arisen under this branch of the subject. The suretyship element in the letter of credit transaction and the assignability of the letter of credit are in a judicially undetermined state.

an action against the defendant bank for damages for loss on materials thrown on the seller's hands and for loss of profits. It was *held* that the contract between the bank and the seller had been repudiated by the bank, and that the principles underlying recovery by the seller against the bank were the same as those underlying recovery by a seller against a buyer in the ordinary case of repudiation of an installment contract, namely, anticipatory breach. The court was bothered by the fact that this was a negotiation credit. The court recognized that ordinarily a negotiation credit can be cancelled as to the future at any time prior to the given negotiation. This case presented the unusual situation of an authority to draw and an authority to purchase issued in the irrevocable form. The court held that a binding contract had been made over the specified period of time. Mr. Justice Rowlatt said in part: "There can be no doubt that upon the plaintiffs' acting upon the undertaking contained in this letter of credit, consideration moved from the plaintiffs, which bound the defendants to the irrevocable character of the arrangement between the defendants and the plaintiff. . . . The credit was irrevocable; and the effect of that was that the bank really agreed to buy the contemplated series of bills and documents representing the contemplated shipments, just as the buyer agreed to take, and pay for, by this means, the goods themselves."

This decision may illustrate an English tendency to apply the offer theory. But it does not necessarily mean this. It must be remembered that the case involved a negotiation credit which is normally worked out on the offer analysis. See 35 HARV. L. REV. 549-551, 567-568, 581-582 (March, 1922).

See also *Equitable Trust Co. v. Keene*, N. Y. Law Journal, Jan. 26, 1922 (decided in the New York Court of Appeals, Jan. 10, 1922).

III

RIGHTS OF THE PURCHASING BANK AGAINST THE
ISSUING AND DRAWEE BANKS

A letter of credit has two characteristics: (1) it contains an authority to one person, the accredited party, to draw bills of exchange and a promise to that person that they will be honored, and (2) it contains a promise to another person, the accrediting party, that if he purchases them the drafts will be honored. What are the rights against the issuing and drawee banks of a *bona fide* purchaser of the drafts drawn in conformity with the provisions of the revocable or irrevocable direct or indirect import or export letter of credit or either form of the advice of credit opened?

The rights of purchasers of drafts may be analyzed on three theories: (1) the letter of credit may be considered as a contract to accept made directly between the issuing and drawee banks and the purchaser; (2) the letter of credit may be considered as an actual acceptance of the drafts; (3) the letter of credit may be regarded as an authority which will enable the purchaser of the drafts to hold the issuing and drawee banks as drawer.

1. *Rights under the Letter of Credit as a Contract*

In reference to prospective purchasers of drafts the letter of credit may contain (1) a specific promise that the drafts will be honored made to a designated person,¹³⁰ or (2) a general promise that the drafts will be honored made to all *bona fide* purchasers,¹³¹ or (3) it may simply authorize the accredited party to draw, and be silent in reference to the accrediting party.¹³²

¹³⁰ *Sigel-Campion Live Stock Commission Co. v. Davis*, 69 Colo. 511, 194 Pac. 468 (1921); *American National Bank v. Pillman*, 176 Mo. App. 430, 158 S. W. 433 (1913); *Union Bank v. Shea*, 57 Minn. 180, 58 N. W. 985 (1894); *First National Bank v. Bensley*, 2 Fed. 609 (1880); *Burns v. Rowland*, 40 Barb. (N. Y.) 368 (1863); *Dickins v. Beal*, 10 Pet. (U. S.) 572 (1836). See *McLaren v. Watson*, 26 Wend. (N. Y.) 425 (1841).

¹³¹ *Bank of Taiwan v. Gorgas-Pierie Mfg. Co.*, 273 Fed. 660 (1921); *Bank of Seneca v. First National Bank of Carthage*, 105 Mo. App. 722, 78 S. W. 1092 (1904); *Oriental Banking Corporation v. Lippert*, 5 Buch. (S. A.) 152 (1875); *Roman v. Serna*, 40 Tex. 306 (1874); *Union Bank of Louisiana v. Coster*, 3 N. Y. 203 (1850).

¹³² *Oil Well Supply Co. v. MacMurphy*, 119 Minn. 500, 138 N. W. 784 (1912); *Putnam National Bank v. Snow*, 172 Mass. 569, 52 N. E. 1079 (1899); *Exchange Bank v. Hubbard*, 62 Fed. 112 (1894); *Bank of Montreal v. Thomas*, 16 Ont. 503 (1888); *First National Bank v. Clark*, 61 Md. 400 (1883); *Franklin Bank of Baltimore v. Lynch*, 52 Md. 270 (1879); *Pollock v. Helm*, 54 Miss. 1 (1876); *Smith v. Ledyard*,

Where the letter is silent, or where it contains a general promise, courts, especially English courts, at first had some difficulty in finding a privity of contract between the writer and the purchaser of the drafts.¹³³ As late as 1842 four leading English barristers¹³⁴ gave it as their expert opinion in an American court that by the law of England the purchaser could maintain no action in his own name against the writer. The first English case which subsequently presented the question was a suit in equity, and the court had no trouble in recognizing the equitable rights of the purchaser as assignee of the drawer's contract right.¹³⁵ The court went further and strongly intimated that an action at law would lie. Later cases seem to have settled the English law to the effect that the purchaser may maintain an action at law in his own name on a direct contract made between himself and the writer.¹³⁶ The seller has a power to communicate the offer and create a contract between the writer and the purchaser of the draft.¹³⁷

The American cases seem never to have been in doubt on this point.¹³⁸ In *Lawrason v. Mason*¹³⁹ Chief Justice Marshall described

49 Ala. 279 (1873); Merchants' Exchange National Bank *v.* Cardozo, 35 N. Y. Super. Ct. 162 (1872); *Ranger v. Sargent*, 36 Tex. 26 (1871); *In re Agra and Masterman's Bank*, *Ex parte Asiatic Banking Corporation*, L. R. 2 Ch. App. 391 (1867); *Vallé v. Cerré*, 36 Mo. 575 (1865); *Bissell v. Lewis*, 4 Mich. 450 (1857); *Monroe v. Pilkington*, 14 How. Pr. (N.Y.) 250 (1857); *Lonsdale v. Lafayette Bank*, 18 Ohio, 126 (1849); *Nisbett v. Galbraith*, 3 La. Ann. 690 (1848); *Birckhead v. Brown*, 5 Hill (N. Y.) 634 (1843); 2 Denio (N. Y.) 375 (1845); *Russell v. Wiggin*, 2 Story, 213 (1842); *Carrollton Bank v. Tayleur*, 16 La. 490 (1840); *Lawrason v. Mason*, 3 Cranch (U. S.) 492 (1806).

¹³³ See *In re Agra and Masterman's Bank*, *Ex parte Asiatic Banking Corporation*, L. R. 2 Ch. App. 391 (1867). See also *Evansville National Bank v. Kaufmann*, 93 N. Y. 273 (1883); *Worcester Bank v. Wells*, 8 Metc. (Mass.) 107 (1844); *Birckhead v. Brown*, 5 Hill (N. Y.) 634 (1843); *Carrollton Bank v. Tayleur*, 16 La. 490 (1840).

¹³⁴ See *Russell v. Wiggin*, 2 Story, 213 (1842). Opinion of Sir William Follett and Sir John Baigley (p. 219); opinion of Sir Frederic Pollock (p. 219); and the opinion of M. D. Hill (p. 220).

¹³⁵ *Iren A rag and Masterman's Bank*, *Ex parte Asiatic Banking Corporation* L. R. 2 Ch. App. 391 (1867).

¹³⁶ See *Chartered Bank of India, Australia & China v. Macfayden & Co.*, 64 L. J. Q. B. 367 (1895); *Bank of Montreal v. Thomas*, 16 Ont. 503 (1888); *Oriental Banking Corporation v. Lippert*, 5 Buch. (S. A.) 152 (1875); *Maitland v. Chartered Mercantile Bank of India, London & China*, 38 L. J. Ch. 363 (1869).

¹³⁷ *Union Bank of Canada v. Cole*, 47 L. J. Q. B. 100 (C. A. 1877).

¹³⁸ *Oil Well Supply Co. v. MacMurphy*, 119 Minn. 500, 138 N. W. 784 (1912); *Putnam National Bank v. Snow*, 172 Mass. 569, 52 N. E. 1079 (1899); *Exchange Bank*

¹³⁹ 3 Cranch (U. S.) 492 (1806).

the letter as "an actual assumpsit to all the world." In *Russell v. Wiggin*,¹⁴⁰ the leading case on this aspect of the letter of credit, Mr. Justice Story, holding that there was a contract between the purchaser and the writer, said:

"The second question is: Whether a promise, contained in a letter of credit, written by persons, who are to become the drawees of bills drawn under it, promising to accept such bills when drawn, which letter, although addressed to the persons, who are to be the drawers of the bills, is designed to be shown to any and all person or persons whatsoever, to induce them to advance money on, and take the bills, when drawn, will be an available contract in favor of the persons, to whom the letter of credit is shown, who advance money and take the bills on the faith thereof, or is void for want of privity between them and the person writing the letter of credit. . . .

"The second question is one, upon which, until I heard the present argument, I did not suppose, that any real doubt could be raised, as to the law, either in England or America. . . .

"I have understood, and always supposed, that . . . the party, giving such a letter, held himself out to all persons, who should advance

v. Hubbard, 62 Fed. 112 (1894); *Brown v. Ambler*, 66 Md. 391, 7 Atl. 903 (1887); *Franklin Bank of Baltimore v. Lynch*, 52 Md. 270 (1879); *Pollock v. Helm*, 54 Miss. 1 (1876); *Smith v. Ledyard*, 49 Ala. 279 (1873); *Northumberland County Bank v. Eyre*, 58 Pa. St. 97 (1868); *Vallé v. Ceré*, 36 Mo. 575 (1865); *Bissell v. Lewis*, 4 Mich. 450 (1857); *Monroe v. Pilkington*, 14 How. Pr. (N. Y.) 250 (1857); *Barney v. Newcomb*, 9 *Cush. (Mass.)* 46 (1851); *Union Bank of Louisiana v. Coster*, 3 N. Y. 203 (1850); *Lonsdale v. Lafayette Bank*, 18 Ohio, 126 (1849); *Nisbett v. Galbraith*, 3 *La. Ann.* 600 (1848); *Russell v. Wiggin*, 2 Story, 213 (1842); *Boyce v. Edwards*, 4 *Pet. (U. S.)* 111 (1830); *Lawrason v. Mason*, 3 *Cranch (U. S.)* 492 (1806). Compare American cases *supra*, note 133. The doubt as to privity expressed in those cases is really a doubt as to whether the letter was intended to be shown as an offer.

¹⁴⁰ 2 Story, 213, 229, 230, 231 (1842).

Letters of credit raise some questions in conflict of laws.

In *Russell v. Wiggin*, 2 Story, 213 (1842) the letter was written and delivered to the buyer in the United States. The draft was drawn and was sold to the plaintiff, the purchasing bank, in England. It was *held* that the contract between the issuing and purchasing banks was made in the United States and that English law did not govern. It may well be that English law would not govern the liability for breach. But it is obviously erroneous to say that the contract was not made in England, and that the law of England should not determine whether plaintiff had a contract right.

See *Brazilian & Portuguese Bank v. British & American Exchange Banking Corporation*, 18 *L. T. R.* 823 (1868).

Compare *North Atchison Bank v. Garretson*, 51 Fed. 168 (1892).

As to what law governs the contract between the drawee and issuing banks and the seller, see *supra*, note 88.

money on bills drawn under the same, and upon the faith thereof, as contracting with them an obligation to accept and pay the bills."

If therefore the letter on its face indicates that it was written for the purpose of being shown,¹⁴¹ in order to obtain the negotiation of bills drawn pursuant to its provisions, and if the purchaser is within the terms of the letter, the letter amounts to an offer to him that if he purchases the drafts the drafts will be honored. The offer becomes a direct unilateral contract between the writer and the purchaser as soon as the draft is bought. This is the explanation of the insistence of the courts that the purchaser must take the draft on the faith of and in reliance on the letter,¹⁴² although it is not necessary that he actually see it:¹⁴³ he must know of the offer and intend to accept it. If the letter contains a specific promise to a designated purchaser no other person can make himself offeree,¹⁴⁴ unless it clearly appears that the letter was also intended to be shown generally.¹⁴⁵ But if the letter is silent, or if it contains a general promise to all *bona fide* purchasers,¹⁴⁶ there is a general offer which may be accepted by any one.

2. Rights on the Bill of Exchange: (a) Against the Issuing and Drawee Banks as Acceptor

In England an acceptance must be written on the bill of exchange.¹⁴⁷ Consequently the letter of credit can never amount

¹⁴¹ *Oil Well Supply Co. v. MacMurphy*, 119 Minn. 500, 138 N. W. 784 (1912); *Atlanta National Bank v. Northwestern Fertilizing Co.*, 83 Ga. 356, 9 S. E. 671 (1889); *Nevada Bank v. Luce*, 139 Mass. 488, 1 N. E. 926 (1885); *Evansville National Bank v. Kaufmann*, 93 N. Y. 273 (1883); *Union Bank of Canada v. Cole*, 47 L. J. Q. B. 100 (C. A. 1877); *Smith v. Ledyard*, 49 Ala. 279 (1873); *Bissell v. Lewis*, 4 Mich. 450 (1857); *Munroe v. Pilkington*, 14 How. Pr. (N. Y.) 250 (1857); *Birckhead v. Brown*, 5 Hill (N. Y.) 634 (1843); *Lawrason v. Mason*, 3 Cranch (U. S.) 492 (1806).

¹⁴² See *Springfield Bank v. Mitchell*, 48 Ill. App. 486 (1892); *Vallé v. Cerré*, 36 Mo. 575 (1865); *Barney v. Newcomb*, 9 *Cush. (Mass.)* 46 (1851); *Worcester Bank v. Wells*, 8 *Metc. (Mass.)* 107 (1844); *McLaren v. Watson*, 26 *Wend. (N. Y.)* 425 (1841).

¹⁴³ *Lewis v. Kramer*, 3 Md. 265 (1852); *Michigan Bank v. Ely*, 17 *Wend. (N. Y.)* 506 (1837).

¹⁴⁴ See *Dickins v. Beal*, 10 *Pet. (U. S.)* 572 (1836). See also cases *infra*, note 214.

¹⁴⁵ *Wilson & Co. v. Niffenegger*, 211 Mich. 311, 178 N. W. 667 (1920); *Union Bank of Canada v. Cole*, 47 L. J. Q. B. 100 (C. A. 1877).

¹⁴⁶ *Bank of Taiwan v. Gorgas-Pierie Mfg. Co.*, 273 Fed. 660 (1921). See cases *supra*, note 131.

¹⁴⁷ For the earlier English law see *Pierson v. Dunlop*, 2 *Cowp.* 571 (1777); *Mason v. Hunt*, 1 *Doug.* 296 (1779). For the later English law see *Bank of Ireland v. Archer*

to an acceptance in favor of a *bona fide* purchaser. In the United States, however, a letter of credit may amount to an actual acceptance in favor of *bona fide* purchasers who take the drafts on the faith of the letter.¹⁴⁸ It is not necessary that a purchaser actually see the letter if he acts in reliance thereon.¹⁴⁹ The classical language of collateral acceptance is to be found in the opinion of Chief Justice Marshall in *Coolidge v. Payson*.¹⁵⁰

"A letter written within a reasonable time before or after the date of a bill of exchange, describing it in terms not to be mistaken, and promising to accept it, is, if shown to the person who afterwards takes the bill on the credit of the letter, a virtual acceptance binding the person who makes the promise."

Whether the purchaser of a draft drawn under a letter of credit proceeds upon the theory of an actual acceptance or upon a contract to accept will make a practical difference in the measure of damages.¹⁵¹

3. Rights on the Bill of Exchange : (b) Against the Issuing and Drawee Banks as Drawer

It has been suggested that the seller is agent for the issuing and drawee banks to draw bills of exchange and that one who purchases

and Daly, 11 M. & W. 383 (1843). Stat. 19 & 20 VICT., c. 97, § 6. See cases cited in Exchange Bank of St. Louis *v.* Rice, 98 Mass. 288 (1867).

¹⁴⁸ *Wilson & Co. v. Niffenegger*, 211 Mich. 311, 178 N. W. 667 (1920); *Bank of Beaver County v. Bradstreet*, 89 Neb. 186, 130 N. W. 1038 (1911); *Milmo National Bank v. Cobbs*, 53 Tex. Civ. App. 1, 115 S. W. 345 (1908); *North Atchison Bank v. Garretson*, 51 Fed. 168 (1892); *Woodard v. Griffiths-Marshall Grain Commission Co.*, 43 Minn. 260, 45 N. W. 433 (1890); *Merchant's Bank of Canada v. Griswold*, 72 N. Y. 472 (1878); *Steman v. Harrison*, 42 Pa. St. 49 (1862); *Lugrue v. Woodruff*, 29 Ga. 648 (1860); *Bissell v. Lewis*, 4 Mich. 450 (1857); *Lewis v. Kramer*, 3 Md. 265 (1852); *Michigan Bank v. Ely*, 17 Wend. (N. Y.) 508 (1837); *Parker v. Greele*, 5 Wend. (N. Y.) 414 (1830); *Coolidge v. Payson*, 2 Wheat. (U. S.) 66 (1817). See *NEGOTIABLE INSTRUMENTS LAW*, §§ 134, 135; *BRANNAN, NEGOTIABLE INSTRUMENTS LAW ANNOTATED*, 3 ed., pp. 361-364 (1920); See also *Exchange Bank v. Rice*, 98 Mass. 288 (1867); *Howland v. Carson*, 15 Pa. St. 453 (1850); *Boyce v. Edwards*, 4 Pet. (U. S.) 111 (1830); *Wildes v. Savage*, 1 Story, 22 (1839); *Brown v. Ambler*, 66 Md. 391, 7 Atl. 903 (1887).

¹⁴⁹ *Woodard v. Griffiths-Marshall Grain Commission Co.*, 43 Minn. 260, 45 N. W. 433 (1890).

¹⁵⁰ 2 Wheat. (U. S.) 66, 75 (1817).

¹⁵¹ *Prehn v. Royal Bank of Liverpool*, L. R. 5 Ex. 92 (1870); *Russell v. Wigggin*, 2 Story, 213 (1842). See 2 *SEDGWICK, DAMAGES*, 9 ed., §§ 700, 707 (1912).

See *Stein v. Hambro's Bank of Northern Commerce*, 9 *Lloyd's List Law Rep.* 433,

the bills on the faith of the letter can maintain an action against the writer of the letter as drawer of the bills, and that no notice of dishonor or protest is necessary.¹⁵² The *dicta* of these cases are, however, contrary to well-settled principles governing parties to negotiable instruments, and the proposition is thoroughly unsound.¹⁵³

4. *Effect of Revocation of the Letter of Credit*

If the letter of credit is issued in the revocable form it constitutes a number of revocable offers. Will a revocation in respect to the seller, if the writer does not destroy or regain possession of the letter, revoke the offer to persons who purchase drafts in ignorance of the revocation? The seller has a power to communicate the offer. Must there be actual authority, or may the purchaser rely

507 (K. B. D., decided Dec. 8, 1921, and Dec. 13, 1921). For the facts of this case see *supra*, p. 715 note 129b. Mr. Justice Rowlatt said in part: "I took time to consider whether the damages which the plaintiff [the seller] was entitled to recover were simply the money equivalent of the bill or whether they were the same damages as he would be entitled to as against a buyer for non-acceptance of the goods. . . . It seems to me that this is clearly a case of a simple contract to pay money upon the fulfillment of conditions which have been fulfilled. . . . The obligation of the bank is absolute, and is meant to be absolute, that when the documents are presented they have to accept the bill. That is the commercial meaning of it. . . . Therefore, it seems to me that the plaintiff is entitled to judgment for the amount of the bill, which should have been accepted, plus interest from the date it would have become due until to-day, and is entitled to the costs of the action."

In Urquhart, Lindsay & Co., Ltd. *v.* Eastern Bank, Ltd., 9 Lloyd's List Law Rep. 572 (K. B. D., decided Dec. 5, 1921), it was held that the seller could recover from the issuing bank damages for loss on materials thrown on the seller's hands and also for loss of profits.

In both of these cases the action was for a breach of contract to accept, which is the only action maintainable in England when the acceptance is not actually written on the draft. So far as damages are concerned, it would seem better to bring an action for breach of contract to accept rather than an action on the acceptance, even where such an action is possible under a letter of credit, for if the letter is treated as an acceptance, only the face of the draft plus interest can be recovered, whereas if the action is brought for breach of contract to accept, the face of the draft may be recovered, or other items of damages may be recovered, such as loss of profits, loss of credit due to cancellation of the letter, and incidental expenses involved in procuring new credit.

See also Belgian Grain & Produce Co., Ltd. *v.* Cox & Co., Ltd., 1 Lloyd's List Law Rep. 256, 546 (C. A. 1919).

¹⁵² See *Exchange Bank v. Hubbard*, 62 Fed. 112 (1894); *Michigan Bank v. Ely, 17 Wend. (N. Y.) 508, 512* (1837).

¹⁵³ *Kirk v. Blurton*, 9 M. & W. 284 (1841); *Grist v. Backhouse*, 4 Dev. & B. (N. C.) 362 (1839); *Siffkin v. Walker*, 2 Camp. 308 (1809). See also 2 AMES, CASES ON BILLS AND NOTES, p. 873 (1894).

upon the apparently unrevoked letter? If the letter of credit is issued in the irrevocable form the same problem arises. There is a contract between the issuing and drawee banks and either the buyer or the seller — for this purpose it matters not whom. A revocation would consequently be a breach of contract in respect to the buyer or the seller for which there is a right of action. But wrong although it is, the writer has a power to revoke the offer to prospective accrediting parties which the letter of credit contains. Is it enough that the actual authority to the drawer has been terminated, or must the writer get the fact of revocation home to all those who may accept the apparent offer? If revocation of actual authority is not enough, the writer's only remedy, in those cases where the seller refuses to surrender or destroy the letter of credit and insists upon his contract rights, is the equitable relief of cancellation. And, although the power of the drawer is not technically a power coupled with an interest, it is doubtful if the writer could under the circumstances obtain cancellation in equity. The practical effect of inability to obtain cancellation would be specific performance of the contract and an irrevocable power in the seller. Again, suppose the amount for which the seller may draw has been exhausted but prior purchasers have neglected to indorse the draft on the letter. Is the writer to be bound to a subsequent *bona fide* purchaser?

The cases are not altogether satisfactory. Where the letter is not intended to be shown, the seller must conform to his actual authority in order to bind the bank to the purchaser.¹⁵⁴ Where the letter is intended to be shown, two cases seem to rest upon the theory of assignment and to measure the purchaser's rights as assignee by the rights of the seller as assignor.¹⁵⁵ Where the letter contains no provision for indorsement but states that the writer will pay drafts to a designated aggregate amount, the purchaser takes the draft at his own risk that the amount has already been exhausted.¹⁵⁶ If the letter requires that the number of the letter be indorsed on the drafts and that drafts drawn under the letter shall be indorsed thereon by purchasers, and the writer pays

¹⁵⁴ *Nevada Bank v. Luce*, 139 Mass. 488, 1 N. E. 926 (1885).

¹⁵⁵ *First National Bank v. Clark*, 61 Md. 400 (1883); *Union Bank of Canada v. Cole*, 47 L. J. Q. B. 100 (C. A. 1877).

¹⁵⁶ *Roman v. Serna*, 40 Tex. 306 (1874); *Ranger v. Sargent*, 36 Tex. 26 (1871).

drafts which are not so indorsed and which were not taken by the purchaser on the faith of the letter, the writer is liable to subsequent purchasers because no contract had been formed with the first purchaser which exhausted the letter, and the letter is an outstanding continuing offer.¹⁵⁷ The cases, therefore, seem to permit the generalization that a prospective purchaser of drafts drawn under a letter of credit may rely on the face of the letter. Thus, if the letter is issued in the revocable form a purchaser acts at his own risk that it has been revoked, but if it is issued in the irrevocable form it is, during the life of the letter, a continuing offer to all *bona fide* purchasers.

IV

RIGHTS OF THE ISSUING AND DRAWEE BANKS

1. Relation of the Sales Contract to the Letter of Credit

The sales contract is no part of the contract between the issuing and drawee banks and the seller. It does not form the consideration for the letter of credit. Nor is performance of the sales contract a condition precedent either of the letter of credit or of the buyer's agreement to reimburse. The letter of credit is a wholly independent contract.¹⁵⁸

A considerable amount of litigation has recently arisen in England and in the United States over the relation of the sales contract to the letter of credit. Since the relation depends upon the terms of the two contracts in so far as they refer to each other, that is upon questions of fact and construction, the litigation upon this point is probably not at an end. It is therefore desirable to set forth briefly the more important recent cases in order to show the way in which the courts have been dealing with this problem.

In the recent case of *Lamborn v. Lake Shore Banking & Trust Co.*¹⁵⁹ it is said:

¹⁵⁷ *Bank of Seneca v. First National Bank of Carthage*, 105 Mo. App. 722, 78 S. W. 1092 (1904); *Omaha National Bank v. First National Bank*, 59 Ill. 428 (1871).

¹⁵⁸ *Bank of Taiwan v. Gorgas-Pierie Mfg. Co.*, 273 Fed. 660 (1921); *Bank of Plant City v. Canal-Commercial Trust & Savings Bank*, 270 Fed. 477 (1921); *Lamborn v. Lake Shore Banking & Trust Co.*, 196 App. Div. 504, 188 N. Y. Supp. 162 (1921); *Imbrie v. Nagase & Co.*, 187 N. Y. Supp. 692 (1921); *American Steel Co. v. Irving National Bank*, 266 Fed. 41 (1920); *Frey & Son v. Sherburne Co. and the National City Bank*, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920); *Baring v. Lyman*, Fed. Cas. No. 983 (1841).

¹⁵⁹ 196 App. Div. 162, 188 N. Y. Supp. 162, 163, 164 (1921).

"This letter of credit constitutes the sole contract with the shipper, and . . . the bank issuing the letter of credit has no concern with any question which may arise between the vendor and the vendee of the merchandise for the purchase price for which the letter of credit was issued. . . . It is clear that the defendant is not under obligation to investigate and ascertain whether the contract between the vendor and vendee has been fulfilled."

In another recent case, *Imbrie v. D. Nagase & Co., Ltd.*,¹⁶⁰ it is said:

"A bank issuing a letter of credit is in no way concerned with any contract existing between the buyer and seller. . . . Disputes between buyer and seller are likewise no concern of it."

In *American Steel Co. v. Irving National Bank*,^{160a} the buyer procured an irrevocable letter of credit authorizing the seller to draw on the issuing bank, drafts to be accompanied by specified shipping documents. Acceptance was subsequently refused by the bank. In an action by the seller against the bank, the bank set up as defenses that the seller failed to make shipment of the merchandise within the time limited by the sales contract, and that, by reason of federal prohibition of exports from the United States of tin plates, the subject matter of the sales contract, the performance of the sales contract became impossible inasmuch as the buyer was unable to obtain a license permitting the export of merchandise within the time required by that contract. The court dismissed the first defense as having no basis in fact. The second defense was held to be bad.

Circuit Judge Rogers said:^{160b}

"The second defense, that the contract became impossible of execution, inasmuch as the MacDonnell Corporation [the buyer] was unable to obtain a license from the United States government permitting the export of the tin plate, is wholly inconsequential. The liability of the bank on the letter of credit as agreed upon between plaintiff and defendant was absolute from the time it was issued, and it was quite immaterial whether the defendant could export the tin or not. . . . The defendant in effect seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right

¹⁶⁰ 196 App. Div. 380, 187 N. Y. Supp. 692, 695 (1921).

^{160a} 266 Fed. 41 (1920).

^{160b} 266 Fed. 41, 43, 44 (1920).

of the MacDonnell Chow Corporation to modify the contract which the bank had made with the plaintiff. We do not so understand the law."

The relation of the sales contract to the letter of credit and the distinct and independent aspects of the two contracts are well brought out by two recent New York cases, the so-called Sugar Injunction Cases.

In *Frey & Son v. E. R. Sherburne Co. and the National City Bank*^{160c} the buyer, a Maryland corporation, entered into a written sales contract in New York with the seller, a Massachusetts corporation. The buyer purchased 350 tons of Java sugar, shipments to be made from Java by steamer or steamers to New York in five separate shipments. Payment was to be made in cash in New York on presentation of a warehouse receipt or delivery order and the buyer was to furnish an irrevocable letter of credit for the full amount of the invoice. The sales contract also provided that if any shipment should be delayed beyond a specified time by unforeseen circumstances the buyer should have the option of cancelling such portion of the contract or of taking the sugar without claim to damages. The buyer procured a letter of credit from the National City Bank authorizing the seller to draw upon that bank. The letter of credit was silent as to the provision for cancelling shipments. One shipment was delayed. The buyer cancelled that shipment under his option. The seller threatened nevertheless to draw the draft upon the bank and to negotiate it. The buyer sought to restrain the seller from drawing the draft and the bank from honoring or paying any drafts which may have been drawn and which may then be in the hands of third parties. The court denied the injunction.

Mr. Justice Greenbaum, writing the opinion of the court, said:^{160d}

"It is equally clear here that the bank issuing the letter of credit is in no way concerned with any contract existing between the buyer and the seller. The bank may only be held liable in case of a violation of any of the terms of the letter of credit. It would thus follow that if the bank paid any drafts violative of the terms of the letter, the buyer would have recourse to the bank in an action for damages for the breach of

^{160c} 193 App. Div. 849, 184 N. Y. Supp. 661 (1920).

^{160d} 193 App. Div. 849, 853, 854, 184 N. Y. Supp. 661 (1920).

its contract. Similarly, if the defendant Sherburne Company [the seller] violated its contract with the plaintiff, [the buyer] the latter has a remedy in an action at law for damages against the defendant. It is not alleged in the complaint that the National City Bank is in financial difficulties. Nor is it alleged that the Sherburne Company is not financially able to respond to damages. . . . Interests of innocent parties who may hold drafts upon the letter of credit should not be made to suffer by reason of rights that may exist between the parties to the contract of sale in reference to which the letter of credit was issued. It would be a calamity to the business world if for every breach of a contract between buyer and seller a party may come into a court of equity and enjoin payments on drafts drawn upon a letter of credit issued by a bank which owed no duty to the buyer in respect of the breach. The parties should be remitted upon their claims for damages to an action at law."

In *Gambrill Mfg. Co. v. American Foreign Banking Corporation Impleaded with E. R. Sherburne Co.*^{160e} the facts were practically the same as those in the preceding case. The buyer sought to restrain the seller from drawing and negotiating the drafts because of an alleged breach of the sales contract. The court examined the provisions of the sales contract and declined to issue the injunction because of the construction which the court put upon that contract.

In other words, the buyer cannot enjoin the drawing and negotiating and acceptance of drafts under the letter of credit contract unless there has been a breach or a non-performance of the letter of credit contract, or unless a condition of that contract has not been met. But the seller may be enjoined by the buyer from drawing and negotiating drafts if there has been a breach or non-performance of the sales contract, or if a condition of that contract has not been met.

A recent English case very neatly brings out the relation between the sales contract and the letter of credit. In *National Bank of South Africa v. Banca Italiana Disconto*^{160f} the seller had sold to one Gaslini in Genoa a cargo of China sesamum seed. Bills of lading were taken out to the order of the shipper, to notify Gaslini.

^{160e} The trial court gave an injunction against the seller but denied an injunction against the bank. 113 Misc. 448 (1920). The Appellate Division reversed the judgment in respect to the seller. 194 App. Div. 425 (1920).

^{160f} 9 Lloyd's List Law Rep. 501 (K. B. D., decided Dec. 9, 1921).

Subsequently the contract between the shipper and Gaslini was cancelled. The seller then entered into a sales contract with the present buyer in respect to the same goods. Payment was to be made by four months' sight drafts on confirmed credits, drafts to be accepted against delivery order or bill of lading. The buyer procured a letter of credit from the Banca Italiana Disconto, authorizing the seller to draw on the National Bank of South Africa in London. This credit was duly confirmed. The letter of credit differed from the sales contract in that it provided for payment against delivery order and fire policy or equivalent documents. The seller presented drafts with bills of lading to the South African bank. This bank took the papers but required the seller to give an indemnity, since the papers did not correspond to the requirements of the letter of credit. The buyer refused to pay for the goods and instructed the Italian bank not to pay. The goods were sold at a loss and the South Africa bank claimed against the seller on the indemnity and against the Italian bank on the letter of credit. Both parties brought in the buyer. Mr. Justice Bailhache gave judgment on the indemnity against the seller but dismissed the claim against the Italian bank. The seller then claimed against the buyer for procuring the letter of credit in terms different from the sales contract. The court gave judgment against the buyer for the price.

Mr. Justice Greer said:¹⁶⁰⁷

"The result is that the defendants [the seller] are in the same position as if they had never had the money at all. But as between the defendants and the third parties, [the buyer] they had done all that was required of them under the contract. They had delivered a good bill of lading to the bank and were entitled to be paid. They have not been paid in the result, and it is not open to the third parties to say that the delivery of this bill of lading to the bank was not a proper delivery which entitled the defendants to their money, because the third parties by their conduct represented that the bank had authority to accept the documents which were deliverable under the contract."

In *Urquhart, Lindsay & Co., Ltd. v. Eastern Bank, Ltd.*, the court said:¹⁶⁰⁸

"In my view, the defendants [issuing bank] committed a breach of

¹⁶⁰⁷ 9 Lloyd's List Law Rep. 501, 506 (1921).

¹⁶⁰⁸ 9 Lloyd's List Law Rep. 572 (K. B., 1921). For the facts of this case see *supra* p. 715 note 129b.

their contract with the plaintiffs [the seller] when they refused to pay the amount of the invoices as presented. Mr. Stuart Brown contended that the letter of credit must be taken to incorporate the contract between the plaintiffs and their buyers, and that, according to the true meaning of that contract, the amount of any increase claimed in respect of an alleged advance in manufacturing costs was not to be included in any invoice to be presented under the letter of credit, but was to be the subject of subsequent independent adjustment.

"The answer to this is that the defendants undertook to pay the amount of invoices for machinery without qualification, the basis of this form of banking facility being that the buyer is taken, for the purposes of all questions between himself and his banker or between his banker and the seller, to be content to accept the invoices of the seller as correct. It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit. The buyer having authorized his banker to undertake to pay the amount of the invoice as presented, it follows that any adjustment must be made by way of refund by the seller and not by way of retention by the buyer."

The analysis of these cases follows necessarily from the analysis that the letter of credit is a contract between the bank and the seller with consideration moving from the buyer to the bank. Non-performance or improper performance¹⁶¹ of the sales contract, in and of itself, is no defense in an action against the bank by the seller¹⁶² or by the purchaser,¹⁶³ and is no ground for equitable relief in the form of injunction by the buyer against the bank's performance of its letter of credit contract.¹⁶⁴

This is the result upon the decisions. But a difference might well be made between cases in which the seller, as the accredited party, is proceeding against the issuing or drawee banks and cases in which the purchasing bank, as the accrediting party, is suing. There are two distinct letter of credit contracts: one between the

¹⁶¹ *Frey & Son v. Sherburne Co. and National City Bank*, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920).

¹⁶² *American Steel Co. v. Irving National Bank*, 266 Fed. 41 (1920).

¹⁶³ *Maitland v. Chartered Bank*, 38 L. J. Ch. 363 (1869).

¹⁶⁴ *Frey & Son v. Sherburne Co. and National City Bank*, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920); *Maitland v. Chartered Bank*, L. J. Ch. 363 (1869).

Compare *National City Bank v. Partola Mfg. Co.*, 191 App. Div. (N. Y.) 424 (1920); *Higgins v. Steinhardtter*, 106 Misc. (N. Y.) 168 (1919), *Welsh v. Gossler*, 89 N. Y. 540 (1882).

issuing and drawee banks and the seller; the other between the issuing and drawee banks and the purchasing bank. In order to charge the purchasing bank with the terms of the sales contract, that contract should be an express condition precedent to the letter of credit contract. But as between issuing and drawee banks and the seller the sales contract might well be construed as an implied condition of the letter of credit. But courts have not made this distinction.

2. *Conditions*

The sales contract, in whole or in part, may be made an express condition precedent to the liability of the issuing and drawee banks on the letter of credit and of the buyer on the agreement to reimburse. Usually the conditions are contained in the letter of credit, and no express conditions are contained in the buyer's agreement. But since this agreement refers to the letter of credit and agrees to its terms, both instruments must be read together, and this is sufficient to make the conditions of the letter of credit conditions precedent to the buyer's liability to put the bank in funds.

The essential thing is that the condition must be a condition of the letter of credit, and not simply a condition of some other contract, such as the sales contract.

"A party who is entitled to draw against a letter of credit must strictly observe the terms and conditions under which the credit is to become available, and if he does not, and the bank refuses to honor his draft, he has no cause of action against the bank."¹⁶⁵ The conditions "cannot be departed from with safety to the mercantile community."¹⁶⁶

If the condition is construed as a condition precedent to performance of the letter of credit contract, courts require the strictest compliance.¹⁶⁷ It has been held, for example, that the issuing

¹⁶⁵ *Lamborn v. Lake Shore Banking & Trust Co.*, 196 App. Div. 162, 188 N. Y. Supp. 162, 164 (1921).

¹⁶⁶ *Murdock v. Mills*, 11 Metc. (Mass.) 5, 13 (1846).

¹⁶⁷ *People's Savings Bank & Trust Co. v. Landstreet*, 87 So. 227 (Fla., 1920); *Palmer v. Rice*, 36 Neb. 844, 55 N. W. 256 (1893); *Lindley v. First National Bank*, 76 Iowa, 629, 41 N. W. 381 (1889); *Brown v. Ambler*, 66 Md. 391, 7 Atl. 903 (1887); *Germania National Bank v. Taaks*, 101 N. Y. 442, 5 N. E. 76 (1886); *Craig v. Marx*, 65 Tex. 649 (1886); *First National Bank v. Bensley*, 2 Fed. 609 (1880); *Brinkman v.*

and drawee banks and the buyer are under no liability where the letter of credit provided that bills of lading,¹⁶⁸ or inspection certificates,¹⁶⁹ should be attached to the draft and no bill of lading or inspection certificate was attached; where the draft was for a larger amount than was provided in the letter of credit;¹⁷⁰ where the letter of credit provided for shipment to one port and the bills of lading showed the destination of the ship to be another port;¹⁷¹ where the letter of credit provided for shipment of produce to be bought and paid for by the seller and the produce was not bought and paid for by the seller;¹⁷² where the letter of credit provided for stock to be shipped and no stock was actually shipped;¹⁷³ where the letter of credit provided for shipment of yellow pine flooring and the bill of lading read yellow pine lumber;¹⁷⁴ where the letter of credit provided for shipment of silk goods of a certain width stripe and the invoice was silent on this point;¹⁷⁵ where by custom certain action on the part of the seller was precluded.¹⁷⁶

Hunter, 73 Mo. 172 (1880); Lockwood *v.* Brownson, 53 Tex. 523 (1880); Michigan Bank *v.* Estate of Leavenworth, 28 Vt. 209 (1855); Murdock *v.* Mills, 11 Metc. (Mass.) 5 (1846); Ulster County Bank *v.* McFarlan, 3 Den. (N. Y.) 553 (1846). Compare Krakauer *v.* Chapman, 16 App. Div. 115, 45 N. Y. Supp. 127 (1897).

For recent cases construing the conditions of letters of credit see Stein *v.* Hambro's Bank of Northern Commerce, 9 Lloyd's List Law Rep. 433 (K. B. D., decided Dec. 8, 1921); Urquhart, Lindsay & Co., Ltd. *v.* Eastern Bank, Ltd., 9 Lloyd's List Law Rep. 572 (K. B. D., decided Dec. 5, 1921); National Bank of South Africa *v.* Banca Italiana Disconto, 9 Lloyd's List Law Rep. 501 (K. B. D., decided Dec. 9, 1921). Belgian Grain & Produce Co., Ltd. *v.* Cox & Co., Ltd., 1 Lloyd's List Law Rep. 256, 546 (C. A. 1919); National Bank of Egypt *v.* Hannevig's Bank, Ltd., 1 Lloyd's List Law Rep. 69 (C. A. 1919). See also Higgins *v.* Steinhardt, 106 Misc. 168 (N. Y., 1919).

¹⁶⁸ First National Bank *v.* Bensley, 2 Fed. 609 (1880); Murdock *v.* Mills, 11 Metc. (Mass.) 5 (1846).

¹⁶⁹ Craig *v.* Marx, 65 Texas, 649 (1886).

¹⁷⁰ People's Savings Bank & Trust Co. *v.* Landstreet, 87 So. 227 (Fla., 1920); Brinkman *v.* Hunter, 73 Mo. 172 (1880).

¹⁷¹ Brazilian & Portuguese Bank *v.* British & American Exchange Banking Corporation, 18 L. T. R. 823 (1868).

¹⁷² Chartered Bank of India, Australia & China *v.* Macfayden & Co., 64 L. J. Q. B. 367 (1895).

¹⁷³ Burke *v.* Utah National Bank, 47 Neb. 247, 66 N. W. 295 (1896).

¹⁷⁴ Brown *v.* Ambler, 66 Md. 391, 7 Atl. 903 (1887).

¹⁷⁵ International Banking Corporation *v.* Irving National Bank, 274 Fed. 122 (1921).

¹⁷⁶ First National Bank *v.* Fiske, 133 Pa. St. 241, 19 Atl. 554 (1890).

The seller¹⁷⁷ and the purchaser of drafts¹⁷⁸ are both subject to the conditions, but on different theories if the letter of credit is of the irrevocable type. The seller has a contract right. Hence it may be possible to relax somewhat the strictness of the conditions.¹⁷⁹ The condition is precedent to performance on the part of the writer, and a number of things may make it inequitable for the writer to insist on the condition.¹⁸⁰ But the purchaser as offeree has no contract right. The condition as to him is precedent to the formation of the contract. The strictest compliance will be required,¹⁸¹ and inequitable conduct of the writer is of no moment. If the condition becomes impossible of performance no contract can arise.

3. *Conduct of the Buyer*

Insolvency of the buyer and consequent failure of consideration,¹⁸² and the state of accounts between the bank and the buyer¹⁸³ are no defenses to the letter of credit against the seller¹⁸⁴ or against

¹⁷⁷ *Lamborn v. Lake Shore Banking & Trust Co.*, 196 App. Div. 504, 188 N. Y. Supp. 162 (1921).

¹⁷⁸ *International Banking Corporation v. Irving National Bank*, 274 Fed. 122 (1921); *People's Savings Bank & Trust Co. v. Landstreet*, 87 So. 227 (Fla., 1920); *Burke v. Utah National Bank*, 47 Neb. 247, 66 N. W. 295 (1896); *Chartered Bank of India, Australia & China v. Macfayden & Co.*, 64 L. J. Q. B. 367 (1895); *First National Bank v. Fiske*, 133 Pa. St. 241, 19 Atl. 554 (1890); *Lindley v. First National Bank*, 76 Iowa, 629, 41 N. W. 381 (1889); *Brown v. Ambler*, 66 Md. 391, 7 Atl. 903 (1887); *Germania National Bank v. Taaks*, 101 N. Y. 442, 5 N. E. 76 (1886); *First National Bank v. Bensley*, 2 Fed. 609 (1880); *Brinkman v. Hunter*, 73 Mo. 172 (1880); *Lockwood v. Brownson*, 53 Texas, 523 (1880); *Brazilian & Portuguese Bank v. British & American Exchange Banking Corporation*, 18 L. T. R. 823 (1868); *Michigan State Bank v. Estate of Leavenworth*, 28 Vt. 209 (1855); *Murdock v. Mills*, 11 Metc. (Mass.) 5 (1846); *Ulster County Bank v. McFarlan*, 3 Den. (N. Y.) 553 (1846). But see *Parker v. Greele*, 5 Wend. (N. Y.) 414 (1830).

¹⁷⁹ See *Krakauer v. Chapman*, 16 App. Div. 115, 45 N. Y. Supp. 127 (1897).

¹⁸⁰ See *Friedlander v. Bank of Australasia*, 8 C. L. R. 85 (H. C. Australia, 1909).

¹⁸¹ *Lindley v. First National Bank*, 76 Iowa, 629, 41 N. W. 381 (1889); *Brinkman v. Hunter*, 73 Mo. 172 (1880); *Lienow v. Pitcairn*, Fed. Cas. No. 8341 (1832). See *First National Bank v. Clark*, 61 Md. 400 (1883).

¹⁸² *In re Agra & Masterman's Bank, Ex parte Asiatic Banking Corporation*, L. R. 2 Ch. App. 391 (1867); *Russell v. Wiggin*, 2 Story, 213 (1842). But see *contra*, *Duncan v. Edgerton*, 19 N. Y. Super. Ct. 36 (1860) (*semble*).

¹⁸³ *American Steel Co. v. Irving National Bank*, 266 Fed. 41 (1920); *In re Agra & Masterman's Bank, Ex parte Asiatic Banking Corporation*, L. R. 2 Ch. App. 391 (1867).

¹⁸⁴ *American Steel Co. v. Irving National Bank*, 266 Fed. 41 (1920).

the purchaser.¹⁸⁵ Nor is the state of accounts between the buyer and the seller a defense to the buyer against the bank.¹⁸⁶ The letter of credit is an independent contract between the issuing and drawee banks and the seller.

The effect of fraud on the part of the buyer in procuring the letter of credit has already been discussed under the rights of the seller against the issuing and drawee banks.¹⁸⁷

Where the commission has not been paid in advance, as soon as the drafts are negotiated the right of the issuing bank to commissions arises, although the buyer should afterwards settle with the seller and with the purchasing bank and destroy the drafts. The commission is for the risks.¹⁸⁸

Where the buyer by his conduct makes performance by the seller of a condition precedent to the letter of credit impossible, the bank, having waived the condition, may recover from the buyer.¹⁸⁹ This result must be explained on the ground that the buyer has rendered the condition precedent to his own agreement to reimburse impossible of performance. This is another indication of the general tendency to treat the transaction which gives rise to a letter of credit as a contract between the bank, the seller, and the buyer, for if the buyer's promise were a mere conditional offer, his conduct in preventing the condition from being performed could be of no moment. The offer would simply be impossible of acceptance.

4. Conduct of the Seller

The issuing bank may recover from the buyer if it strictly complies with its contract.¹⁹⁰ What amounts to compliance? The alleged improper performance of the sales contract is no defense

¹⁸⁵ *Miltenberger v. Cooke*, 18 Wall. (U. S.) 241 (1873); *In re Agra & Masterman's Bank, Ex parte Asiatic Banking Corporation*, L. R. 2 Ch. App. 391 (1867).

¹⁸⁶ *Palmer v. Rice*, 36 Neb. 844, 55 N. W. 256 (1893).

¹⁸⁷ See 35 HARV. L. REV. 569, 573, 579-581, 583 (March, 1922).

¹⁸⁸ *Baring v. Lyman*, Fed. Cas. No. 983 (1841).

¹⁸⁹ *Friedlander v. Bank of Australasia*, 8 C. L. R. 85 (H. C. Australia, 1909).

¹⁹⁰ *Munroe v. Bonanno*, 16 App. Div. 421, 45 N. Y. Supp. 61 (1897) (mistake); *Bank of Montreal v. Recknagel*, 109 N. Y. 482, 17 N. E. 217 (1888); *Gelpcke v. Quentell*, 74 N. Y. 599 (1878); *Johnson v. Blakemore*, 28 La. Ann. 140 (1876); *Ulster Bank v. Synnott*, I. R. 5 Eq. 595 (1871); *Ex parte Agra Bank, In re Barber & Co.*, L. R. 9 Eq. 725 (1870); *De Tastett v. Crousillat*, Fed. Cas. No. 3828 (1807). For a case involving the relation between the issuing bank and the drawee bank see *National Bank of Egypt v. Hannevig's Bank, Ltd.*, 1 Lloyd's List Law Rep. 69 (C. A. 1919).

to the issuing or drawee banks or to the buyer unless the performance is an express condition precedent of the letter of credit. But active misconduct of the seller in forging or altering bills of lading or other shipping documents is not so easily disposed of. The buyer's agreement to reimburse the issuing bank usually contains an express provision that the bank shall be under no liability in respect to goods or shipping documents.¹⁹¹ Even in the absence of such provision it is held that the bank assumes no responsibility in respect to forged¹⁹² or altered¹⁹³ bills of lading, or other shipping documents,¹⁹⁴ or defects in quality¹⁹⁵ or quantity of the goods.¹⁹⁶ That the bank is not legally responsible for defects in quality and quantity of the goods seems plain. Actual shipment of specified goods may of course be made a condition precedent of the buyer's agreement to reimburse,¹⁹⁷ or of the letter of credit,¹⁹⁸ and the promisor may insist upon strict compliance. Where there is such a condition, the purchasing, issuing, and drawee banks may not rely simply on the documents. They act at their own risk that the condition has been performed. In the usual case, however, where there is no such condition the issuing and drawee banks' undertaking is to accept and pay specified drafts with specified shipping documents attached, and the banks may therefore rely on the face of the documents.¹⁹⁹ The case of forged documents

¹⁹¹ For a case where the express provision had a legal effect different from the effect if there had been no provision, and an effect contrary to the intention of the parties, see *Borthwick v. Bank of New Zealand*, 17 T. L. R. 2 (1900).

¹⁹² *Ulster Bank v. Synnott*, I. R. 5 Eq. 595 (1871); *Craig v. Sibbett*, 15 Pa. St. 238 (1850). See *Guaranty Trust Co. v. Hannay*, [1918] 2 K. B. 623 (C. A.); *Woods v. Thiedemann*, 1 H. & C. 478 (1862). Compare *Allen v. Hornor*, 2 McGloin (La.) 177 (1884).

¹⁹³ *Young v. Lehman*, 63 Ala. 519 (1879).

¹⁹⁴ *Basse and Selve v. Bank of Australasia*, 90 L. T. R. 618 (K. B. 1904).

¹⁹⁵ *Bank of Plant City v. Canal-Commercial Trust & Savings Bank*, 270 Fed. 477 (1921); *American National Bank of Macon, Georgia v. Pillman*, 176 Mo. App. 430, 158 S. W. 433 (1913); *Benecke v. Haebler*, 38 App. Div. 344, 166 N. Y. Supp. 631 (1899).

¹⁹⁶ *Lemon Importing Co. v. Garfield Savings Bank*, 105 Misc. 627, 173 N. Y. Supp. 551 (1919); *Borthwick v. Bank of New Zealand*, 17 T. L. R. 2 (1900).

¹⁹⁷ *Bank of Montreal v. Recknagel*, 109 N. Y. 482, 17 N. E. 217 (1888).

¹⁹⁸ *Bank of Montreal v. Recknagle*, 109 N. Y. 482, 17 N. E. 217 (1888); *Allen v. Hornor*, 2 McGloin (La.) 177 (1884).

¹⁹⁹ *International Banking Corporation v. Irving National Bank*, 274 Fed. 122 (1921); *Bank of Plant City v. Canal-Commercial Trust & Savings Bank*, 270 Fed. 477 (1921); *Young v. Lehman*, 63 Ala. 519 (1879); *Ulster Bank v. Synnot*, I. R. 5 Eq. 595 (1871).

is not so plain. The issuing and drawee banks, having accepted or paid, a forged draft under a letter of credit cannot charge the buyer.²⁰⁰ And it may be argued that the same result should follow where the shipping documents are forged, that the agreements of the banks and of the buyer are to pay drafts accompanied by genuine shipping documents, and that consequently where the shipping documents are forged neither the issuing nor the drawee banks can be held by the purchasing bank, nor can the buyer be held by the issuing bank, and that if the buyer or the issuing and purchasing banks pay in ignorance of the forgery they may respectively recover back the money so paid as money paid under an essential error. But the great weight of authority is to the effect that the ultimate risk in respect to forged shipping documents is on the buyer. The purchasing, issuing, and drawee banks are not selling goods or shipping documents but are surrendering security. The purchasing bank, having in good faith taken the shipping documents, which purport to be genuine and are regular on their face, may recover from the issuing and drawee banks,²⁰¹ and the issuing bank may recover from the buyer.²⁰² This result has been explained on the ground that the buyer, having selected his seller, should be responsible for his acts in respect to shipping documents;²⁰³ and that, when the money has been paid under mistake as to genuineness of shipping documents, the error is collateral and not essential.²⁰⁴ The better reason is that the exigencies of commerce demand that the loss should not fall on the banks. Any other result would unduly hamper business.²⁰⁵

²⁰⁰ *British Linen Co. v. Caledonian Insurance Co.*, 4 Macq. 107 (1861); *Orr & Barber v. Union Bank of Scotland*, 1 Macq. 513 (1854).

²⁰¹ *Bank of Plant City v. Canal-Commercial Trust & Savings Bank*, 270 Fed. 477 (1921); *First National Bank v. Fiske*, 133 Pa. St. 241, 19 Atl. 554 (1890); *Brown v. Ambler*, 66 Md. 391, 7 Atl. 903 (1887); *Young v. Lehman*, 63 Ala. 519 (1879); *Craig v. Sibbett*, 15 Pa. St. 238 (1850). See *WILLISTON, SALES*, § 435 (1909).

²⁰² *Basse and Selve v. Bank of Australasia*, 90 L. T. R. 618 (K. B. 1904).

²⁰³ *Basse and Selve v. Bank of Australasia*, 90 L. T. R. 618 (K. B. 1904); *Ulster Bank v. Synnott*, I. R. 5 Eq. 595 (1871). Compare with the question of the effect of fraud of the buyer in procuring the letter of credit.

²⁰⁴ *Springs v. Hanover National Bank*, 145 App. Div. 188, 130 N. Y. Supp. 87 (1911).

²⁰⁵ *Young v. Lehman*, 63 Ala. 519 (1879).

5. Right to the Goods

The sales contract and the letter of credit may provide that the goods shall be shipped on bills of lading to the order of the buyer, or to the order of the seller and indorsed in blank, or to the order of the issuing bank. Generally it is provided that the bills of lading shall be made to the order of the issuing bank. Prior to acceptance, the purchasing bank, in such a case, has a pledgee's right to the goods represented by the shipping documents. After acceptance, the shipping documents do not follow the draft. The issuing bank has the right to the goods. If the drawee bank should become insolvent the purchasing bank's only right is on the bill of exchange. The goods are not held in trust for holders of the drafts. A letter of credit account is in no respects a trust account.²⁰⁶

After acceptance, what is the relation in respect to the goods between the issuing bank and the buyer? The buyer's agreement with the bank provides that legal title shall remain in the issuing bank until the buyer puts the bank in funds to meet the drafts drawn under the letter of credit. As between the buyer and the issuing bank, the buyer is in reality beneficial owner and the issuing bank has only a bare legal title for security. The relation is essentially that of mortgagor and mortgagee. The bank may insist on holding the goods until the buyer carries out his agreement. But such insistence is to the interest of neither the buyer nor the bank. It is therefore the usual practice for the issuing bank, as soon as the goods arrive, to deliver them to the buyer on a bailee (more properly agency) receipt or on a trust receipt. If a bailee or agency receipt is employed, the buyer is simply bailee with a power of sale who has undertaken to remit proceeds to the bailor as fast as the goods are sold. If a trust receipt is employed, the buyer is given legal title as trustee with power to sell and hold the proceeds in trust for the bank. In either case, if the transaction is given effect according to its purport the bank is protected if the buyer should become insolvent. But in essence the transaction is a mortgage with the mortgagor in possession. At common law the bank is protected. The transaction should however be within

²⁰⁶ *Ex parte* Dever, *In re* Suse, 13 Q. B. D. 766 (C. A. 1884); *In re* Barned's Banking Co., *Banner & Young v. Johnston*, L. R. 5 H. L. 157 (1871); *In re* Barned's Banking Co., *Coupland's Claim*, L. R. 5 Ch. App. 167 (1869).

the chattel mortgage recording acts, and if unrecorded, the bank should be allowed to file a claim against the buyer only as a general creditor.²⁰⁷ The tendency of the courts, however, is to consider the issuing bank as full beneficial and legal owner of the goods, with a contract right in the buyer, and therefore to give effect to the transaction as a bailment or a trust.²⁰⁸

V

THE SURETYSHIP ELEMENT IN THE LETTER OF CREDIT TRANSACTION

If one or more of the banks become insolvent, or if there is an extension of time, or a release of securities, or an attempted assignment of the letter of credit, it may be important to determine whether there is a suretyship relation between the parties.

It is arguable that when the sales contract provides that the buyer shall procure a letter of credit the seller agrees to accept payment exclusively in that manner. The contract right against the bank is payment. The seller henceforth looks only to the bank, and the bank looks to the buyer.²⁰⁹ If this explanation of the transaction is correct, the issuing and drawee banks would not be sureties for the buyer in any sense. If, however, the seller has a right to proceed against the buyer for the purchase price of the goods, there is between the bank and the buyer suretyship in its broad sense. Both are liable for the same debt. As between the buyer and the issuing bank the buyer should ultimately pay. The buyer is therefore principal, and the issuing bank is surety. But when the buyer pays the purchase price to the issuing bank the bank becomes principal and the buyer is surety. That the bank is not a guarantor,

²⁰⁷ *In re* Bettman-Johnson Co., Petition of Goldman, Sachs & Co., 250 Fed. 657 (1918). See WILLISTON, SALES, § 437 (1909), for the buyer's power to deal with documents and with goods entrusted to him under a trust receipt, and the probable effect of the Uniform Sales Act thereon.

²⁰⁸ *Vaughan v. Massachusetts Hide Corporation*, 209 Fed. 667 (1913); *Moors v. Drury*, 186 Mass. 424, 71 N. E. 810 (1904); *Mershon v. Moors*, 76 Wis. 502, 45 N. W. 95 (1890); *New Haven Wire Co. Cases*, 57 Conn. 352, 18 Atl. 266 (1889); *Moors v. Wyman*, 146 Mass. 60, 15 N. E. 104 (1888); *Moors v. Kidder*, 106 N. Y. 32, 12 N. E. 818 (1887).

²⁰⁹ See *Hindley & Co. v. Tothill, Watson & Co.*, 13 N. Z. L. R. 13 (C. A. 1894); *contra*, *Bell v. Moss*, 5 Whart. (Pa.) 189 (1839); *Birckhead v. Brown*, 5 Hill (N. Y.) 634 (1843).

or surety in the narrow sense, is clear. Its obligation is primary and not secondary, even though the word *guaranty* is used.²¹⁰

Whatever may be the situation between the buyer and the banks, it is clear that under the indirect import and the direct export letters of credit there is a suretyship relation between the issuing and drawee banks. If no relation of principal and agent exists between them, but nevertheless the drawee bank issues its own irrevocable or confirmed letter of credit, the seller has two rights prior to acceptance and payment: one against the drawee bank, and the other against the issuing or credit-opening bank. The obligation of the issuing bank is in the nature of a secondary or conditional obligation, and the obligation of the drawee bank is in the nature of a primary or unconditional obligation. As between themselves the issuing bank is principal and the drawee bank is surety. If in issuing the indirect import letter of credit the issuing bank acts as agent for the drawee bank, the drawee bank is principal and the issuing bank is guarantor in the narrow sense. If there is also an obligation running from the buyer to the seller, and if no relation of principal and agent exists between the banks, then as between buyer, issuing bank, and drawee bank, the buyer is principal, the issuing bank is surety, and the drawee bank is surety for the issuing bank or sub-surety and not a co-surety. But if the relation of principal and agent exists, the buyer is principal, the drawee bank is surety, and the issuing bank is guarantor for the drawee bank or a sub-surety and not a co-surety.

The chief importance of a determination of the suretyship element relates to the question of assignability of the letter of credit.

VI

ASSIGNABILITY OF THE LETTER OF CREDIT

Story in writing of letters of credit has said:²¹¹

"In respect to letters of credit, which are in common use in our commerce with foreign countries, it may be stated that a letter of

²¹⁰ *Bank of Italy v. Merchants' National Bank*, 113 Misc. 314, 185 N. Y. Supp. 43 (1920); 188 N. Y. Supp. 183 (1921). See *Lafargue v. Harrison*, 70 Cal. 380, 11 Pac. 636 (1886). See also *Lonsdale v. Lafayette Bank*, 18 Ohio, 126 (1849). A sales contract may of course be guaranteed by a bank. *Moers v. Den Norske Handelsbank*, 191 App. Div. 114, 180 N. Y. Supp. 743 (1920). For clear cases of offers for guaranties see *Holmes v. Schwab & Sons*, 141 Ga. 44, 80 S. E. 313 (1913); *Adams v. Jones*, 12 Pet. (U. S.) 207 (1838); *Douglass v. Reynolds*, 7 Pet. (U. S.) 113 (1833).

²¹¹ STORY, BILLS OF EXCHANGE, 3 ed., § 459 (1853).

credit (sometimes called a bill of credit) is an open letter of request, whereby one person (usually a merchant or a banker) requests some other person or persons to advance monies, or give credit, to a third person, named therein, for a certain amount, and promises that he will repay the same to the person advancing the same, or accept bills drawn upon himself, for the like amount. It is called a general letter of credit when it is addressed to all merchants, or other persons in general, requesting such advance to a third person; and it is called a special letter of credit, when it is addressed to a particular person by name, requesting him to make such advance to a third person."

Daniel adds:²¹²

"Letters of credit are instruments of frequent use in commerce, and while not possessing all the characteristics of negotiability which pertain to bills and notes, partake of them to such an extent as to be necessarily classed as negotiable instruments."

This definition and classification of letters of credit, in common with all such definitions and classifications, is concerned only with the second aspect of the letter of credit: the relation between the writer of the letter and the accrediting party. If the promise to purchasers of drafts drawn by the accredited party is a general or open promise, any person may accept the offer and enter into contractual relations with the writer. It is in this sense that Daniel and Story used the term *negotiable*.²¹³ A letter of credit is in no proper sense a negotiable instrument.

If A writes: "To whom it may concern: Please sell goods to B (or purchase his drafts on me) and I will pay," the letter is termed a general letter of credit. Any person who sells goods to B or purchases B's drafts on A on the faith of the letter can maintain an action against A. It is a general offer.

If A writes: "To S: Please sell B goods which he may desire and I will pay" (or "To P: S is authorized to draw on me. Please purchase his draft and I will honor it") the letter is termed a special letter of credit. No one but the person addressed can recover. The reason which is most often given is that the letter constitutes a guaranty and the guarantor cannot be held unless the terms of the guaranty are strictly complied with. The true explanation

²¹² 2 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., §§ 1790-1800 (1914).

²¹³ See STORY, BILLS OF EXCHANGE, 3 ed., § 461 (1853).

is that such a letter is an offer directed to a specific offeree. No one but the offeree addressed can accept the offer.

If A writes: "To S: You are authorized to draw bills on me, and I promise to honor them," the law was for a time puzzled whether to class the letter as a special or a general letter of credit. It is addressed to a specific person but this person is the accredited party. The essential inquiry is, Who is the accrediting party addressed? And so it became settled that this is a general letter of credit. It is a general offer which may be accepted by any one.

Special and *general* are words applicable only to the accrediting party and not to the accredited party. They relate only to the character of the offer. They have no reference to the question of assignment of an existing legal right. If some one other than the offeree seeks to accept the offer no legal right arises.²¹⁴ The question, Can a letter of credit be assigned? is a totally different question. It is concerned with the first aspect of the letter of credit, with the right of the accredited party.

In the case of the modern types of letters of credit those which are offers to the seller clearly cannot be taken advantage of by one other than the offeree. Where the letter is of the irrevocable type and confers a contract right upon the seller to draw bills on the writer, the seller has a right *in praesenti*, subject to certain conditions precedent. The seller's right is freely assignable²¹⁵ as long as the conditions are performed, and are capable of being performed by one other than the seller, or, in other words, as long as the conditions are not personal. But it must be admitted that an assign-

²¹⁴ Such is the explanation of the following cases, some of which state that a letter of credit is not assignable: *Fletcher Guano Co. v. Burnside*, 142 Ga. 803, 83 S. E. 935 (1914); *Lyon v. Van Raden*, 126 Mich. 259, 85 N. W. 727 (1901); *Crane Co. v. Specht*, 39 Neb. 123, 57 N. W. 1015 (1894); *State National Bank v. Young*, 14 Fed. 889 (1883); *Evansville National Bank v. Kaufmann*, 93 N. Y. 273 (1883); *First National Bank v. Bensley*, 2 Fed. 609 (1880); *Johnson v. Brown*, 51 Ga. 498 (1874); *Smith v. Montgomery*, 3 Tex. 199 (1848); *Taylor v. Wetmore*, 10 Ohio, 490 (1841); *Dickins v. Beal*, 10 Pet. (U. S.) 572 (1836); *Sollee v. Meugy*, 1 Bailey Law (S. C.) 620 (1830); *Walsh and Beekman v. Bailie*, 10 Johns. (N. Y.) 180 (1813); *Robbins v. Bingham*, 4 Johns. (N. Y.) 476 (1809); *Grant v. Naylor*, 4 Cranch (U. S.) 224 (1808). See *Burke v. Utah National Bank*, 47 Neb. 247, 66 N. W. 295 (1896); *McLaren v. Watson*, 26 Wend. (N. Y.) 425 (1841). Compare *Wilson & Co. v. Niffenegger*, 211 Mich. 311, 178 N. W. 667 (1920).

²¹⁵ See *Evansville National Bank v. Kaufmann*, 93 N. Y. 273 (1883).

ment would destroy the usefulness of a letter of credit. No purchaser would discount drafts drawn by some one other than the seller, because he would not be accepting the writer's offer. This objection would not apply to the cash credit. But as between the seller and the writer there are difficulties. One purpose of the letter of credit is to assure the buyer that the goods have been shipped. The issuing bank cannot charge the buyer unless it adheres strictly to the letter of credit contract. If the bills of lading have been taken out or if drafts have been drawn by one other than the seller, the issuing bank would refuse to take the risk that it could recover from the buyer. And it should be permitted to take this position. This does not however affect the assignability of rights under the letter of credit transaction. If the sales contract can be assigned so as to confer rights against the buyer, then the right to draw under the letter of credit should also be assignable. To this extent the sales contract has an important connection with the letter of credit. The bank should be allowed to insist for its own protection upon being assured that the sales contract has been so assigned, and was capable of being so assigned. Although the bank may be justified in refusing to accept drafts drawn by one other than the seller, or bills of lading showing shipment by one other than the seller, because it may be assuming too great a risk, this does not affect the assignee's right in equity against the bank if all the parties to the letter of credit are made parties to the suit, and the assignability of the sales contract is established. The same result should follow even if the bank is a surety. It can make no difference to the surety who his creditor is. But as a practical matter there are so many difficulties and inconveniences involved that an ordinary letter of credit would be assigned only with the intention of giving the assignee a security interest against the assignor. Since the letter must by its terms be presented for the negotiation or acceptance of drafts, its possession is a thing of value in the hands of an assignee. Further affirmative rights would necessarily have to be left to a court of equity to determine. In order to make an assignment a practical matter, the letter should have a provision in reference to assignment. Some letters do have the express provision that they are assignable if written notice is given to the issuing bank by the seller or by the buyer.²¹⁶

²¹⁶ See *Duncan v. Edgerton*, 19 N. Y. Super. Ct. (6 Bosw.) 36 (1860).

VII

CONCLUSION

At the present time there exists a considerable body of law on commercial letters of credit. There have been decided about two hundred cases which deal with different problems connected with these letters. About twenty-five of these cases are English, Scotch, Irish, and British Colonial cases. The rest are American decisions. About fifty of the two hundred deal with the modern letter of credit transaction as it appears in international trade. Most of the cases have arisen in connection with the direct and indirect types of letters of credit. The advices of credit opened have been very little litigated. Most of the cases are concerned with rights of purchasers of drafts drawn under the letter. Comparatively few deal with the rights of the seller. It has been sought, in the footnotes to this article, to classify the most important of these cases in reference not only to the legal problem involved, but also to the type of letter of credit which was under discussion.

The most important question connected with commercial letters of credit is the nature of the right of the seller as the accredited party. This has not been definitely worked out, but the American law seems to be crystallizing. Upon other questions the law is clearer. The rights of the purchaser of drafts, as the accrediting party, the rights of the issuing and drawee banks, the relation of the sales contract to the letter of credit, the effect to be given to conditions of the letter of credit, the effect of insolvency of the buyer, of fraud of the seller, and the relation between the issuing bank and the buyer in respect to the goods seem to be settled. The two interesting problems connected with commercial letters of credit in reference to which there has been as yet no judicial determination are the problem of the effect of the fraud of the buyer in procuring the letter and the problem of assignment.

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